Neeraj Bhagat & Co.

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Demat & Securities Experts

Benefits of Dematerialization of Shares in India

How Electronic Securities Have Transformed Investor Experience and Market Efficiency

https://neerajbhagat.com/dematerialization-of-shares-in-india/

Eliminating the Risks of Physical Share Certificates

The most fundamental benefit of dematerialization is the elimination of the numerous risks associated with holding securities in physical certificate form. Physical share certificates, by their nature, are vulnerable to a range of adverse events that can cause significant financial harm to investors — harm that is entirely avoided when securities are held in electronic form.

Theft and Loss: Physical share certificates can be stolen, misplaced, or accidentally destroyed. While theft does not transfer ownership (since a thief cannot legally transfer shares without the registered owner's signature), it creates enormous inconvenience and requires a complex, time-consuming process to obtain duplicate certificates — typically involving a police complaint, publication of a newspaper advertisement, an indemnity bond, and a court surety in some cases.

Fire and Natural Disasters: Certificates stored at home or even in bank lockers can be destroyed by fire, floods, or other natural disasters. The loss of the original certificate triggers the same complex duplicate certificate process. In contrast, electronic holdings are replicated across multiple secure server locations, making them virtually immune to physical destruction.

Forgery and Fraud: Fake or forged share certificates were a significant problem in India before dematerialization, causing substantial investor losses. In the physical system, it was difficult for buyers to instantly verify the authenticity of a certificate. In the dematerialized system, the electronic record in the depository's database is the definitive proof of ownership, and any transaction involving the securities is authenticated through the secure NSDL/CDSL infrastructure.

Bad Delivery: In the pre-demat era, a significant proportion of physical share deliveries were 'bad deliveries' — certificates that were not in order for transfer due to signature issues, transfer deed problems, or incomplete

Cost Savings and Operational Efficiency

Dematerialization has delivered substantial cost savings across the entire Indian securities ecosystem — for individual investors, for companies, for brokers, and for market infrastructure institutions. These cost savings arise from multiple sources and collectively represent a significant improvement in market efficiency.

Stamp Duty Elimination: Prior to dematerialization, the transfer of shares required the payment of stamp duty — a state government tax applied on the value of the physical transfer deed. Transfers of shares in dematerialized form through a depository are exempt from stamp duty under the Indian Stamp Act, saving investors and companies significant costs on every transaction involving securities.

Elimination of Paper Costs: Companies no longer incur the cost of printing, distributing, and maintaining records of physical share certificates for their shareholders. The cost of physical certificate issuance — including design, printing on security paper, distribution by courier, and storage of duplicate certificate applications — was substantial for companies with large shareholder bases.

Faster Settlement: The shift from the T+2 to the T+1 settlement cycle in India (completed in January 2023) would not have been possible without the efficiency of the dematerialized system. For investors, faster settlement means that sale proceeds are available sooner for reinvestment, improving capital efficiency. For brokers, faster settlement reduces counterparty exposure and margin requirements.

Reduced Custodial Costs: Institutional investors previously bore significant costs for the physical custody of large certificate portfolios — secure storage, insurance, transportation, and administrative management. The demat system has eliminated these costs entirely, redirecting resources to more productive investment activities. For retail investors, the annual cost of holding even a large portfolio of dematerialized securities is typically just a few hundred rupees of AMC

Benefits for Investors vs Benefits for Companies

BENEFITS FOR INVESTORS
Safety: No risk of loss, theft, or forgery
Convenience: Single Demat account holds all securities
Speed: T+1 settlement — money and securities available next day
Corporate actions: Automatic credit of bonus, dividend, rights
Pledge facility: Shares can be pledged digitally for loans
Transparency: Real-time portfolio visibility
Nomination: Simple online nomination for succession planning
Consolidation: Odd lots can be merged into marketable lots
Lower cost: No stamp duty on transfers, no physical handling
Global access: NRIs can manage Indian portfolio from abroad

BENEFITS FOR COMPANIES
Cost savings: No printing/distribution of physical certificates
Sharehold accuracy: Depository maintains authoritative shareholder list
Corporate action efficiency: Automated dividend, bonus distribution
Reduces disputes: Electronic record eliminates transfer disputes
Regulatory compliance: Easier SEBI/MCA compliance reporting
Faster fundraising: Electronic share allotment in primary markets
ESOP management: Seamless digital allotment on option exercise
Investor relations: Electronic communication to all shareholders
Audit trail: Complete transaction history for regulatory review
Market credibility: Demat compliance signals governance quality

Measurable Benefits of Dematerialization

T+1

Settlement Cycle (Down from T+5 Pre-Demat)

Nil

Stamp Duty on Demat Share Transfers

Zero

Bad Deliveries in Demat System

Auto

Corporate Actions Credited Without Investor Action

₹0

Cost of Physical Custody in Demat System

48 Hrs

Max Time to Credit Pledge Release

Pledging Dematerialized Shares: Using Securities as Collateral

One of the most practically useful features enabled by dematerialization is the ability to pledge dematerialized shares and other securities as collateral for loans from banks, non-banking financial companies (NBFCs), and stockbrokers. This pledge facility allows investors to monetise their portfolio without selling their investments, providing liquidity without disrupting their long-term investment strategy.

The process of pledging dematerialized shares is entirely electronic and significantly faster than pledging physical assets. The investor submits a pledge request through their DP's online platform, specifying the securities to be pledged and the beneficiary (the lending institution). The lending institution accepts the pledge through its own DP interface. Once both parties confirm, the pledge is registered in the depository's records within one business day.

Bank Loans Against Securities (LAS): Banks offer loans against the security of dematerialized equity shares, mutual fund units, bonds, and other securities. The loan amount is typically a percentage of the market value of the pledged securities — known as the Loan to Value (LTV) ratio — which varies from 50% to 80% depending on the type of security and the bank's policy. Interest rates are generally lower than unsecured personal loans, making LAS an attractive liquidity option for investors with substantial equity portfolios.

Margin Funding by Brokers: Stockbrokers also offer margin funding — a form of loan that allows investors to purchase more securities than their current cash balance would permit, with existing dematerialized holdings serving as collateral. The broker's margin facility is governed by SEBI's margin regulations, which specify the eligible securities, LTV ratios, and disclosure requirements.

Release of Pledge: When the loan is repaid, the lender releases the pledge by initiating an unpledge

Dematerialization and the Growth of India's Capital Market

The relationship between dematerialization and the growth of India's capital market is not merely correlational — it is fundamentally causal. The introduction of the demat system in the late 1990s laid the infrastructure foundation upon which India's equity culture has been built over the past two and a half decades. Without dematerialization, the explosive growth in retail investor participation, the expansion of the mutual fund industry, and the emergence of India as a globally significant capital market would not have been possible.

The number of Demat accounts in India has grown from less than one million in 2000 to over 150 million in 2024 — a 150-fold increase reflecting the massive democratization of capital market access. This growth has been particularly pronounced in the post-2020 period, driven by easy online account opening, the rise of discount brokers with zero brokerage models, the emergence of investment apps like Zerodha and Groww, and a significant increase in retail investor awareness and financial literacy.

The T+1 settlement milestone achieved in January 2023 — placing India ahead of most developed markets that continue to operate on T+2 or T+3 cycles — was a direct consequence of the maturity and efficiency of India's dematerialized market infrastructure. Faster settlement has further reduced systemic risk, freed up investor capital, and enhanced India's attractiveness as an investment destination for foreign portfolio investors.

Looking ahead, SEBI has announced plans to move to an instantaneous or T+0 optional settlement in a phased manner, beginning with select securities. This ambition is only possible because of the robust foundation that dematerialization has created. As India continues to attract retail investors, foreign institutional investors, and new categories of securities into its capital market, the Demat infrastructure will remain the foundational pillar on which this growth is built.

Maximise the Benefits of Dematerialization with Expert Guidance

The benefits of dematerialization extend far beyond regulatory compliance — they touch every aspect of investing, from safety and convenience to cost savings and market access. Neeraj Bhagat & Co. helps investors and companies navigate the demat ecosystem and leverage its full potential for financial growth and security.

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